19716 0

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

COMMENTS OF THE

OHIO RAIL DEVELOPMENT COMMISSION

February 29, 2000

BEFORE THE

SURFACE TRANSPORTATION BOARD

EX PARTE 582

PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

COMMENTS OF THE

OHIO RAIL DEVELOPMENT COMMISSION

February 29, 2000

Ohio was and is at the epicenter of the impacts of the Conrail Sale. While we believe we will see some positive impacts, the experience to date has been marked by very substantial negative consequences. In light of the problems which have resulted from recent railroad consolidations, it is prudent to step back and examine the path North America's Class I railroads are taking. We applaud the Surface Transportation Board (STB) for recognizing the problem and for having the foresight to take proactive action to address it.

The Ohio Rail Development Commission (ORDC) encourages the STB to continue their extensive analysis of the economic service and environmental impacts as it reviews the proposed merger between the Canadian National - Burlington Northern/Sante Fe (CN/BN) proceedings and other such proceedings which will undoubtedly follow.

In this regard, ORDC asks that the STB consider the following:

1) Reexamine the policy that only two railroads are needed to provide effective rail to rail competition.

2) Recognize that no matter how much preliminary planning goes into a railroad consolidation, the initial impact on service is almost always negative and the ultimate impacts are not possible to accurately predict. Recognize that allowing for an increased level of input from state governments may be valuable in considering the implications of merger proposals and in providing implementation problems feedback

3) Recognize that when the STB fails to mandate adequate environmental mitigation, the burden of the mitigation falls back to the state and local taxpayers.

4) Recognize that the monetary losses which many small railroads and rail users

experience when Class I railroad consolidations go awry will probably never be recovered.

5) Recognize that the benefits of the efficiencies from future rail mergers may not necessarily be passed on to rail users.

6) Do not rush to judgement on railroad consolidation proposals. Ensure that railroads have delivered on past promises of rail merger benefits before allowing more mergers. Do your own analysis of what you believe the final transcontinental railroad system should be like.

1) RAIL TO RAIL COMPETITION

In its past decisions on Class I rail mergers and consolidations, the STB has steadfastly maintained that a reduction in rail to rail competition is not significant until and unless the number of available railroads is reduced to one. In the Conrail Sale process, the STB did not recognize that the reduction in rail competition from three railroads to two could have adverse impacts.

ORDC believes that it is time for the STB to reexamine this policy. With the upcoming CN/BN merger proposal, it does not take a great deal of imagination to picture a scenario in the very near future where there are only two, giant Class I transcontinental railroads operating in Canada and the United States. ORDC contends that it is premature to assume that where only two giant Class I's exist, the competition is as vigorous as it needs to be. In the east, the Norfolk Southern (NS) and CSX "diopoly" has only existed for less than a year, with both railroads struggling merely to get their systems running. This merger has so far been a major service calamity at taxpayers' expense. In the west, the Union Pacific/Southern Pacific (UP/SP) and BN/SF mergers have only provided a very brief glimpse as to how badly a diopoly could work.

ORDC understands that rail rivals like NS and CSX have, and will, continue to vigorously compete for prize traffic. However, ORDC can readily imagine that with only two rail suppliers it is quite probable that there will be areas where the quality and availability of service will diminish, especially when prize traffic is not involved.

An example of how industries dominated by a small number of competitors can become less aggressive and less responsive to customers is the US auto industry. When General Motors, Ford, and Chrysler experienced decades of supremacy in the 1950's and 60's, their product lines reflected the lack of competition. It took the introduction of competition from the Japanese and German automakers to show how unresponsive the Big 3 automakers had become to the market.

ORDC believes that the STB should solicit input from rail users, short line and regional railroads, economic experts, and state governments on the subject of how much rail competition is truly enough. Some rail users in Ohio have told ORDC that three or four Class I's are needed to ensure effective competition. While prognostication is never 100% accurate, the issue of rail competition is too important to leave to the process of trial and error. The STB should have a good idea what lies at the end of the transcontinental merger path before taking it.

2) RAIL MERGERS AND CONSOLIDATIONS ARE UNPREDICTABLE

Despite having the UP/SP merger fiasco as an example, despite the best efforts by the NS and CSX to avoid a similar meltdown, and despite the efforts of the STB to ensure that NS and CSX would not repeat the mistakes of the past, rail users, short line and regional railroads, and communities continue to suffer severe adverse impacts from the Conrail Sale transaction.

Even though Ohio opposed the Conrail Sale, even we did not anticipate that the problems NS and CSX would encounter would be so serious and have such grave negative impacts.

Perhaps if state governments were provided a more active voice during the proposal process, some of the problems experienced in the implementation of the Conrail Sale could have been avoided. ORDC understands the demands placed upon the STB's staff and resources. We believe that expanding the role state governments can play during the merger proposal period can supplement the STB's diligent efforts in analyzing the potential impacts of any merger application. State governments, naturally, are more familiar with needs of their businesses, industries, and citizens. Particularly, environmental impacts on communities can be more effectively assessed by state governments familiar with the geographic and demographic make-up of the impacted communities than by overburdened STB staff depending on two-dimensional maps and mathematical formulas.

With the benefit of hindsight, the parties involved in the UP/SP and Conrail Sale processes can see what went wrong and how it could have been done better. ORDC wonders if transcontinental railroad mergers will ever go smoothly.

There is no template for giant, coast to coast rail mergers involving not only different railroads, but different countries and laws. For example, ORDC understands that under the Canadian system, invoices and record-keeping are held in secret. US commodity buyers are not permitted to determine their actual rail freight costs. This is not in the public interest. A meltdown on a transcontinental rail merger could have international adverse impacts. ORDC believes we all need to do more homework in this area before we proceed.

3) BURDEN OF MITIGATION FALLS ON TAXPAYERS

In the Conrail Sale process, the issue for which Ohio fought hardest was the mitigation of the impacts increased train traffic would have on Ohio communities and neighborhoods. Although Ohio is grateful that the STB did provide an unprecedented amount of environmental mitigation, ORDC believes that the mitigation efforts fell short, especially in the area of grade separations.

On February 17 of this year, Governor Bob Taft announced a $200 million grade separation program. Ohio expects to use this program to build approximately 40 new grade separations over the next 10 years. Of the $200 million, only about $20 million is expected to come from the railroads, the rest of the burden being shouldered by Ohio taxpayers.

The increased train traffic on rail lines and in rail yards which resulted directly from the Conrail Sale made this new grade separation program necessary.

Congestion from an increased number of trains going through and stopping at NS classification yards, such as Bellevue, Ohio, and CSX classification yards, such as Willard, Ohio, has resulted in a major problem with blocked crossings. While ORDC and other state officials know that much of the problem is temporary and will be rectified as NS and CSX invest in more track projects and locomotives, and add more crews, it is clear that many blocked crossing problems will persist as long as the Ohio rail yards continue to be heavily used.

Even when trains are moving, there are problems resulting from the Conrail Sale. For example, in neighborhoods in the Cleveland suburb of Berea, train traffic has risen from 14 daily trains to 70 trains per day on some days. Rail safety is particularly affected.

At a great cost, Ohio is adjusting to the impacts of changed rail traffic patterns resulting from the Conrail Sale. In addition to the $200 million grade separation program, local communities are spending countless dollars on smaller scale improvements in local police, fire, and emergency response services to better handle the new problems they face resulting from increased train traffic. More taxpayer dollars are going into special hazmat training and other related areas. All this Ohio taxpayer money going into mitigation begs the question: "Can the taxpayers of Ohio afford any more rail mergers?"

4) RAIL USER AND SMALL RAILROAD LOSSES NEVER RECOVERED

ORDC closely monitored the service problems on the NS and CSX in the first few months after their June 1, 1999 takeover of Conrail. Virtually every small railroad ORDC contacted had a list of problems with the NS and/or CSX service, all of which cost them money. One category of losses was wasted train and crew time. The most common complaints were about crews waiting to get into yards or onto NS or CSX lines over which they had trackage rights. Fortunately, most of these problems have dissipated. When questioned about recovering their wasted costs, some of the small railroads said that they would seek to recover some of it, but had no hopes of being fully reimbursed. Most said that their small railroad would simply have to absorb the cost.

A much more troubling category of loss was lost rail traffic. Most small railroads have suffered the loss of good rail traffic to trucks or other modes because their Class I partner could not perform. Loss of traffic is especially troubling because once the traffic leaves the railroad, it may take years to recover it. Or it may never come back to the railroad again.

ORDC believes that when evaluating the Conrail sale, the STB may have been more concerned that small railroads would gain some undue advantage from their requested conditions, than it was about the small railroads being hurt by the Class I transaction. In light of what actually happened in the Conrail Sale (and in the UP/SP merger), ORDC urges the STB to reevaluate its philosophy on small railroads.

Small railroads have kept alive many lines which the Class I's have discarded. The Class I's often enjoy increasing traffic from these discarded lines, traffic built up with sweat equity and cash investment from the small railroad, and, in many instances, with the assistance of taxpayer grants. The STB should be fair in evaluating requests from small railroads. Some small railroads may try to get something for nothing at the Class I's expense. But for reasonable requests, the STB should give the small railroad the benefit of the doubt. As the number of Class I's shrink, keeping short lines and regionals vibrant, through new trackage rights or other means, may be the only way to help preserve effective rail to rail competition.

5) FUTURE MERGER BENEFITS WON'T NECESSARILY PASS TO RAIL USERS

Despite the current problems with the Conrail Sale, ORDC believes that ultimately NS and CSX will deliver many benefits to Ohio because of the transaction. Hopefully, one of the major benefits will be that truck traffic will be diverted to rail. This diversion of truck traffic should be possible because many freight movements which were two-line hauls when Conrail existed are now one-line hauls for NS or CSX. Costs and timeliness of two-line hauls were barriers to rail winning the traffic. Because distances involved in many of the moves NS and CSX will capture from trucks are not overly long, NS and CSX will have to offer a competitive rate and timely service to capture and maintain the diverted truck traffic. This is especially true for today's Just In Time (JIT) service needs.

While NS and CSX emphasized diversion of truck traffic as a major benefit of the Conrail Sale, ORDC has not seen CN/BN make the same claim. Diverting truck traffic is much more difficult in a transcontinental merger because the end to end nature of the transaction does not present the same opportunities as a largely parallel transaction such as the Conrail Sale.

With truck competition being much less effective in keeping rail rates and service disciplined, ORDC questions how much of the benefits from transcontinental mergers will actually be passed on to rail users. ORDC has had some experience in working with railroad marketing personnel. When asked how they price a move, the answer is often "5% below the truck rate". However, truck load rates are generally one to one-and-one-half times more expensive than rail; rail remains the least expensive way to move bulk commodities by land. But if the transcontinental merger is primarily making existing rail moves more efficient, and not diverting new traffic from trucks, what market force will compel Canadian or American controlled transcontinentals to pass on savings to the rail user?

ORDC believes that the STB should gather unbiased expert testimony as to where the benefits of transcontinental mergers will actually accrue. ORDC suspects that in large part, the efficiency benefits will only be booked by the merger partners, not the shippers. ORDC suspects that only genuine rail competition will guarantee that system savings will be passed on to the shipper.

6) DO NOT RUSH TO JUDGEMENT

Once the first transcontinental merger occurs, more are certain to follow. Ready or not, the UP/SP, NS, and CSX will be concentrating on who will be their rail partner for life, at the expense of concentrating on their current underwhelming operations.

At minimum, the STB should not allow any railroad which has not delivered on all of the promises it made about the benefits of a past merger to submit an application for a new merger. The nation is still waiting to see the benefits of the recent spate of Class I consolidations. Certainly, Ohio has not yet seen the upside of the Conrail Sale, and if the trade journals are to be believed, the UP/SP and BN/SF mergers of 1995 have yet to reach their advertised potential. The STB has wisely decided to keep an oversight period on the Conrail Sale. ORDC believes that state governments could have a role during the implementation period of a merger. State government officials are often contacted by the shortline railroads, business and industry representatives, and local community officials and their citizens to assist them with the problems they are experiencing during implementation of the Class I railroads' plan. Developing and strengthening communication between state governments and the STB will provide the STB with a better understanding of any merger's results.

Before the first transcontinental railroad is allowed to be formed, the STB should have a clear picture of what life in the United States and Canada will be like with only two Class I railroads. To date, no US controlled railroad has been allowed to operate in Canada, but now Canada wants to operate one of its own railroads in the United States. Should there not be reciprocity?

The expedited procedures the STB has implemented for rail abandonments and other minor transactions have certainly worked well and served a good purpose. However, the expedited timetables in the last four mega-mergers have not served the nation well. In two out of the four mergers, the result of the expedited time frame was nothing less than disastrous.

ORDC asks the STB the question: "What is the hurry?" Where are the public convenience and necessity for more mega-mergers? Who is pushing the mega-merger trend? Not the shippers; not the states; not the local communities. It is only the railroads themselves.

ORDC urges the STB to proceed with a deliberate pace. It needs to understand what has just taken place in the merger area, especially in the UP/SP and Conrail Sale transactions. It needs to put an end to the whirlwind approach to merger evaluation. The STB should consider spending the time and money to do an overall evaluation of what the transcontinental railroad system in the United States and Canada can and should be like before proceeding with new mega-mergers. The STB needs to determine what information it wants, and what information it believes is vital to making decisions about how the final round of mega-mergers will proceed, then gather it and properly analyze it in due course. ORDC believes that state governments can take a lead role in gathering, analyzing, and presenting this information to the STB for this evaluation.

The current process for evaluating mergers, i.e., the railroads proposing and the rest of the world reacting, is a good one and a necessary one. But it should not be the only one. The current STB process, with the continuing improvements the STB has been adding, is certainly appropriate for determining the specifics of the final round of transcontinental mergers. Nevertheless, the STB should carefully consider and establish its own basic framework for the final solution before the actual merger applications are heard.